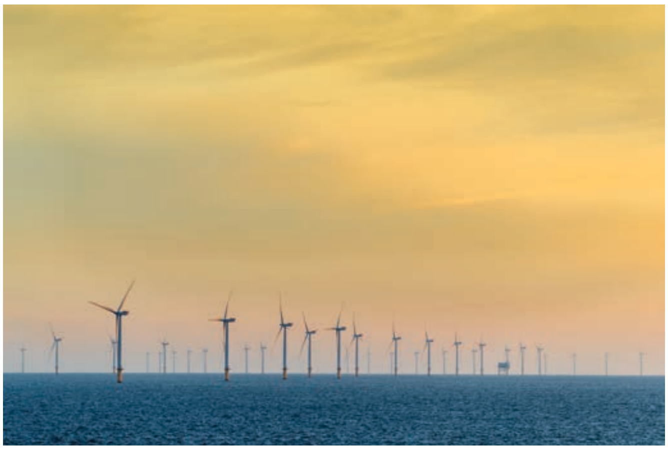
Wind of change

Alun Oliver reviews the recent Court of Appeal decision *Orsted West of Duddon Sands (UK) Ltd and others v CRC* that has overturned the previous Upper Tribunal decision.



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The case now held largely in favour of the appellants – Orsted West of Duddon Sands (UK) Limited, Gunfleet Sands II Limited, Gunfleet Sands Limited and Walney (UK) Offshore Windfarms Limited – all members of a group of companies of which the ultimate parent is Ørsted A/S, a Danish company, allowing them to benefit from significant capital allowances on their construction expenditure in creating the Gunfleet, Orsted West and Walney offshore wind farms – within UK territorial waters.

Background

Between 2000 and 2003 Orsted had successfully bid to develop the various sites to create offshore windfarms. Each consisted of a collection or array of wind turbine generators, which are usually identical and are connected together electrically by cables and then further connected via substations to the public grid.

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To give a sense of scale of these windfarms, Gunfleet, off the coast of Essex, comprises 30 and 18 wind turbines in phases 1 and 2 respectively; Walney, off the coast of Cumbria, is made up of 102 turbines; and West of Duddon Sands in the Irish Sea, comprises 108 turbines. They came 'onstream' as operational between August 2009 and January 2014.

The original case was heard by the First-tier Tribunal (FTT) – referenced as *Gunfleet Sands Limited and others* (TC8387) – in which the details of the projects were set out. Each turbine's 50-60 metre long blades are supported by a tower which, in turn, is connected to a 'monopile' foundation by a 'transition piece'. The monopile is a cylindrical steel tube which is driven or drilled into the sea bed. As the FTT noted in paragraph 51 of its decision, the evidence before it was that 'each of the monopile foundations in the windfarms in these appeals was physically unique, save for one pair of foundations at Walney which were identical'.

The expenditure under challenge has become known as 'predevelopment expenditure' and caused extreme turbulence in the world of capital allowances (and the renewables sector) by refusing some £48m of capital costs incurred across the projects on preliminary investigations – deemed by the taxpayer as essential fees incurred on the provision of the plant and machinery.

HMRC had argued successfully, in part, that some of these studies were not expenditure on the provision of plant and machinery at the Upper Tribunal (UT) decision issued in October 2023.

Disallowed expenditure included: environmental impact assessments (EIA), landscape, seascape and visual assessments; Benthos studies (identifying the impact on Benthic organisms living in or on the seabed); ornithologic and collusion risk studies (exploring migration routes that might be impacted); fish and shell fish studies (to understand which species were in the vicinity of the windfarm and export cable routes, and might be of conservation or commercial interest); marine mammal studies; archaeological studies (to determine the number of maritime sites and finds such as known wrecks, reported losses and recorded obstructions within the area of the windfarm), determining the number of known sites and finds of historic settlement and occupation; noise studies; telecoms and radar interference studies; traffic,

Key points

- HMRC disputed whether predevelopment expenditure qualified for capital allowances.
- First-tier Tribunal allowed some expenditure but the Upper Tribunal later overturned that decision.
- The Court of Appeal's decision on capital allowances hinged on the interpretation of 'qualifying expenditure' under CAA 2001, s 11.
- It determined the Upper Tribunal's view had been too narrow – the studies provided essential information for the design and installation of the windfarms, making them eligible for capital allowances.
- It found the expenditure was capital as it was made as lump sum payments with a view to enduring advantages.

transport and access analyses (to consider aviation and maritime collision risk); as well as socio-economic and tourism assessment.

Tax points of law

The FTT's decision, released on 3 February 2022, addressed several key tax issues:

- Single item of plant: It concluded that each 'windfarm', comprising all of the respective wind turbines, array cables and substations, constituted a single item of plant for the purposes of capital allowances, but not each turbine.
- Qualifying expenditure: The tribunal allowed capital allowances for some of the studies, particularly those directly related to the design and installation of the windfarms. It held that expenditure on design necessary for the windfarms to function effectively qualified for allowances under CAA 2001, s 11.
- Revenue deduction: It rejected the claim for revenue deductions under CTA 2009, s 61, considering the expenditure to be capital in nature.
- Conclusive determination: The tribunal found that the amounts in the tax returns of Gunfleet, Gunfleet II and Walney had not been conclusively determined and could be revisited.

The UT had re-considered whether or not the expenditure on the many studies was within CAA 2001, s 11(4) which determines that expenditure generally is qualifying expenditure if 's 11(4)(a) it *is capital expenditure on the provision of plant or machinery* wholly or partly for the purposes of the qualifying activity carried on by the person incurring the expenditure'. The UT ultimately found many of these pre-commencement studies, in its view, were not on the provision of plant and machinery, and held that some were too remote from the capital assets to qualify.

While the FTT had interpreted 'capital expenditure on the provision of plant or machinery' widely, encompassing all capital expenditure which was necessary for the design and safe construction of the windfarms, the UT took a much narrower view, leading to this further challenge by Orsted to the Court of Appeal.

Much learned case law – mostly held in high esteem by capital allowances advisers brought up digesting in detail these case decisions that underpin the basis of the rare and specialist world and without an utterance of 'embedded plant' – was explored and interrogated including: *Yarmouth v France* [1887] 19 QBD 647, *CIR v Barclay Curle Co Ltd* [1969] 45 TC 221, *Ben Odeco Ltd v Powlson* [1978] STC 460, *Cole Brothers Ltd v Phillips* [1980] STC 518, *Attwood (HMIT) v Anduff Car Wash Ltd* [1997] STC 1167, *JD Wetherspoon plc v CRC* [2012] STC 1450, *Cheshire Cavity Storage 1 Ltd v CRC* [2022] STC 622, *Urenco Chemplants Ltd and another v CRC* [2023] STC 54.

The UT decision created a maelstrom of concern among, not only the offshore wind sector, but also all major infrastructure projects (as well as capital allowances advisers) concerned at where the boundary now lay for the tax treatment of design or predevelopment costs. This concern was vocalised across the energy and renewables sectors as contrary to the government's focus on green energy, net zero and carbon capture – leading to the 2024 Budget announcement by Chancellor Rachel Reeves of new consultations in spring 2025 (see my article 'Food for thought', *Taxation*, 13 February 2025) as well as being highlighted in the Treasury's October 2024 *Corporate tax roadmap* at page 10 (tinyurl.com/govctroadmapoct24).

A potential appeal to the Supreme Court, should HMRC seek to fight on, might result in more delay by the Treasury and HMRC including these aspects in any imminent consultation – if not perhaps deferring the whole process for some months yet.

On the provision of plant and machinery

The case arguments also explored guidance from HMRC's *Capital Allowances Manual*; specifically CA20070 'professional fees and preliminaries' which states:

> 'Professional fees, such as survey fees, architects' fees, quantity surveyors' fees, structural engineers' fees, service engineers' fees or legal costs, only qualify for PMA [ie plant and machinery allowances] as expenditure on the provision of plant or machinery if they relate directly to the acquisition, transport and installation of the plant or machinery and as such are part of the expenditure incurred on the provision of the plant or machinery.'

The same rule of law applies to preliminaries too. Preliminaries are the indirect site establishment and temporary works costs that facilitate the construction often incurred over the duration of a project on items such as site management, insurance, general purpose labour, temporary accommodation and security, etc.

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The Court of Appeal's decision on capital allowances hinged on the interpretation of 'qualifying expenditure' under CAA 2001, s 11. The court considered whether the costs of various studies conducted before the windfarms became operational were incurred 'on the provision of' plant and machinery. While there was acknowledgement that the term 'provision' should not be interpreted too narrowly, it noted that expenditure on design and installation could qualify for capital allowances if it was necessary for the windfarms to function effectively. Determining that UT had been too narrow in its consideration of s 11, the decision emphasised that the studies provided essential information for the design and installation of the windfarms, making them eligible for capital allowances.

Elizabeth Wilson KC, who appeared for HMRC, supported the UT's decision, arguing that the narrow application applied only to the supply and installation of the physical items. Citing the dicta from Lord Hailsham in *Ben Odeco* – which restricted the inclusion of finance and interest charges from being eligible for capital allowances – Ms Wilson contended the wider studies were too remote, only feeding into the decision by Orsted as to 'what, if any and how it might be installed'.

Noting that *Ben Odeco* also illustrated that costs can extend beyond the simple purchase price, such that expenditure could include 'such items as transport and installation', Newey LJ stated his agreement with the FTT findings that 'what is at issue in the present case is not expenditure incurred on the physical process of installing the generation assets, but the costs of studies which are said to have informed how installation should be effected. In my view, such costs can potentially also be said to have been incurred "on the provision of" the generation assets.'

> "Allowances were rightly available on landscape, seascape and visual assessment; ornithology and collision risk; noise; and telecoms and radar interference studies."

He added: 'It appears to me that s 11 encompasses costs of design as well as costs of installation, and that the eligible expenditure will extend to costs of studies which informed such installation or design.' Hence he found in favour of the taxpayer – extending the scope of eligible expenditure for capital allowances across the majority of the additional studies as being 'costs ... incurred "on the provision of" the generation assets', including:

- Landscape, seascape, and visual assessments: These studies influenced the design of the windfarms by recommending the arrangement of turbines, blade configuration, colour schemes and navigation lights.
- Ornithology and collision risk studies: These informed the design and installation of the windfarms by recommending lighting and other measures to mitigate the impact on birds.
- Noise assessment studies: These proposed measures to mitigate noise during construction and operation, influencing the installation process.
- Geophysical and geotechnical studies: These provided crucial data for the design and installation of the windfarms, including the positioning of turbines and the characteristics of the seabed.

Orsted had withdrawn the capital allowances claim against socio-economic and tourism studies or the desktop metocean studies. However, Newey LJ expanded on the FTT decision also considering that allowances were rightly available on landscape, seascape and visual assessment; ornithology and collision risk; noise; and telecoms and radar interference studies.

Revenue deduction

The treatment of costs as revenue was a secondary argument proffered with the expectation that if capital allowances were not available, then the expenditure should be considered as revenue expenditure and deductible under CTA 2009, s 61.

Newey LJ, rejected the appellants' claim for revenue deductions. He drew on precedents from earlier capital versus revenue cases, such as *ECC Quarries Ltd v Watkis* [1977] 1 WLR

1386, [1975] STC 578, *Tucker (HMIT) v Granada Motorway Services Ltd* [1979] STC 393 and particularly the distinction between the two types of expenditure in the opinion of Viscount Cave LC in *British Insulated and Helsby Cables Ltd v Atherton* [1926] AC 205, 213-214, where he said:

> 'When an expenditure is made, not only once and for all, but with a view to bringing into existence an asset or an advantage for the enduring benefit of a trade, I think that there is very good reason (in the absence of special circumstances leading to an opposite conclusion) for treating such an expenditure as properly attributable not to revenue but to capital.'

The court noted that the expenditure was made once and for all, with the aim of enhancing the value of the leases, the windfarms and their respective businesses – as lump sum payments with a view to enduring advantages – and so capital.

Conclusive determination

Michael Jones KC, counsel for Osted, argued that HMRC not having amended the amounts given for 'qualifying expenditure' within the closure notices, was to be taken to have been 'conclusively determined' pursuant to FA 1998, Sch 18 para 88.

Citing *Investec Asset Finance plc v CRC* [2020] STC 1293, he said that the 'matters in question' as regards the appeals to the FTT were limited to the amendments which HMRC had made in the closure notices. He further argued that the proper construction of TMA 1970, s 50 is at the heart of this part of the appeal and while he accepted that, were it the case that the 'qualifying expenditure' amounts could be revised under s 50, Sch 18 para 88 would not render them 'conclusively determined'. He maintained that s 50 did not authorise changes to the 'qualifying expenditure' figures and that there was a distinction between part of a tax return where HMRC had made an alteration and those elements which HMRC had left untouched.

At paragraph 135, Newey LJ determined that 'where an appeal is brought under paragraph 34(3) of Schedule 18 to FA 1998, the FTT can do more than merely correct the specific amendment(s) if that is necessary to give effect to its conclusions on the "matter in question". The requirement to read TMA 1970, s 50 "subject to any necessary modifications" does not, as it seems to me, limit the FTT to revising the amendment(s) in such a case. As I see it, s 50 is intended to empower the FTT to carry its conclusions on the "matter in question" into effect and so to ensure that the taxpayer pays the correct amount of tax'. As such, it was valid that the FTT decided that tax due could be revised in light of the case decision, even if the closure notices had not amended the relevant returns.

Court of Appeal's decision

Newey LJ, handing down a unanimous judgment (supported by Zacaroli LJ and Sir Launcelot Henderson), did not accept the UT's overly narrow interpretation of what constitutes qualifying expenditure, commenting against their cited reliance on *Barclay Curle* and *Ben Odeco* restrictions that:

> 'If, as a matter of ordinary language, a taxpayer incurs expenditure "on the provision of" plant from which, potentially, it will earn taxable profits, it is not obvious that parliament should not have wished all such expenditure to be eligible for capital allowances.'

The other points on revenue deduction and conclusive determination were dismissed.

Conclusions

This decision is not simply relevant to wind farms or large infrastructure projects but goes to the very heart of all capital allowances claims. The wider project costs, be they preliminaries or professional fees should always be carefully considered, and as here, where there is a specific link between the design and installation of the relevant asset, then those costs should at least in part be recoverable against the capital allowances claimed – as plant and machinery or integral features and apportioned against them, as relevant. However, the more recent expansion of capital allowances since 29 October 2018 to include structures and buildings allowances perhaps now 'mops' up some of these costs that for Orsted might otherwise have been ineligible for tax relief.

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Subject to an appeal to the Supreme Court, this case provides greater clarity for all major projects on the availability of capital allowances for a significant proportion of their predevelopment costs where these are closely attributed to the provision of the asset, and not too remote. For tax relief to have the intended outcomes – of helping to drive investment by businesses into these major infrastructure schemes – a degree of certainty is essential. Otherwise these global operators will simply choose to invest their hard earnt cash outside the UK – impacting jobs, growth and prosperity and greatly slowing the pace of change in the important and transformative renewables sector.

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